Scope and Approach for Today

- **Conceptual**: not a literature review
  - But happy to address questions about specific studies or literatures
- **Focus on** payday loans to *fix ideas*
  - But happy to address other products
The Evidentiary Basis for Rulemaking: Key Questions

1. What do we need to know?
2. What do we know?
3. What should we do, in light of 1 and 2?
Key Takeaways

1. **Humility**
   - We don’t know much

2. **Restraint**
   - Hard to improve outcomes if we don’t know much

3. **Innovation**
   - Weak motivation for standard “protections”
     - Quantity restrictions
     - Point-of-sale disclosure
   - Many “surgical” approaches hold promise

- **Punchline:** a 21st-century agency should approach this space with a direct (social) marketing and R&D mindset
What Constitutes “Evidence” for “Evidence-Based Policymaking”?

-A methodology that convincingly addresses the classic social science problem and plausibly identifies cause and effect
-Tempting to abandon this standard in the small-dollar space. So much seems/feels broken:
  - Pew tells “Jennifer’s” Story
  - But… everyone has a story: “This was exactly what I needed…”
-Microcredit serves as cautionary tale of story-based policymaking
  - Pro-small-dollar “movement” built on theory, anecdotes, rigged evaluations
  - Little causal evidence of transformative impacts
  - Now backlash
Insufficient Evidence

- Ban Enacted and Lending Falls
  - What happens to consumer well-being?

- Payday borrowers fare worse than non-borrowers
  - People who go to the E.R. fare worse...

- Expensive
  - So is hiring a plumber

- Serial borrowing
  - Should we outlaw serial borrowing in the repo, commercial paper market?

- Loans finance “recurring expenses”
  - Money is fungible! Example: borrowing to pay rent today because I paid cash for emergency last week
What Do We Need to Know? To Decide Whether Should Intervene

-Does small-dollar do more harm than good?
  • Evidence on this from rigorous studies is mixed
    ➢ Even within-Zinman studies!
    ➢ Tilts “good” if include evidence from developing countries
  • Why mixed evidence?
    ➢ Substance: true heterogeneity in impacts, studies across different settings reflect this
    ➢ Methods: some flawed

-Punchline: evidence does not move us away from standard priors
  • More good than harm (revealed preference)
  • “80-20 rule”
What Do We Need to Know? To Decide Whether Should Intervene

- Is market on its way to providing alternatives that marginalize the payday model?
  • Reducing Distribution Costs
    • Employer-intermediated lending
    • Online
  • Improving Risk-Based Pricing
    • Underwriting based on new data sources
    • Behavioral approaches for advantageous selection
  • Reducing Credit Risk
    • Contracting innovations (flexibility, maturity, dynamic pricing)
    • Monitoring innovations (referral bounties, peer support)

- Related: why gap in the “lending ladder”?
  • Asymmetric information?
What We Need to Know? To Decide *How* Should Intervene

- Why do people go wrong?
  - *Repayment expectations: overly optimistic, or inattentive*
    - Mann and Pew evidence on this suggestive, but shaky, and neither finds that majority are overly optimistic
  - Price perceptions conditional on expectations
    - Problem if interest compounds (e.g., with rollovers)
  - *Temptation*

- Fixes should *target* these *biases*
What We Need to Know? To Decide How Should Intervene

• How effective will fix be at changing behavior?
  • Of consumers
  • Of regulated lenders
  • Of unregulated lenders

• How costly to implement a fix?
  • TILA example: costly enforcement leads to limited enforcement
    ➢ Smaller lenders, loan sharks
Evidence-Based Policymaking in the Shadows: What Should a 21st-Century Agency Do?

Objectives:
1. Reach people early, at decision point
2. Rely on incentive-compatible 3rd parties instead of enforcement
3. Preserve access for those who do themselves no harm
Evidence-Based Policymaking in the Shadows: What Should a 21st-Century Agency Do?

Strategies:

1. Beta-test to generate evidence
   - “Soft” vs. “hard” launches
2. Try scalpels before sledgehammers
   - Identify problems and target fixes
Solving for Asymmetric Information

20\textsuperscript{th} century: subsidies

21\textsuperscript{st} century: “Catalyst”-type approach

- Support evaluation of promising underwriting/business models
- Help solve standards, legal barriers to information gathering and sharing
Solving for Optimism Bias

20th century approaches:
• Restrict rollovers, mandate disclosures
  ➢ Enforcement costs daunting in fragmented market, low entry barriers

21st century approaches:
1. “Engagement”
2. Beta-testing: iterate to proven solutions
• Outgoing direct (social) marketing:
  ➢ “Have you thought about how to repay?”
  ➢ “Imagine a friend is deciding whether to use a payday loan… what would you advise them to do?”
• “Smart” disclosures based on prior behavior, predictive modeling
Solving for Temptation

20th century approaches: bans, mandatory cooling off periods

21st century approach: **Beta-test voluntary versions of these (“commitment devices”).**

- (Can think of this as voluntary licensing)
- Self-cooling: “Don’t release $ for N days after I apply”
- Self-banning: “Cut me offs”
  - After X loans in a calendar year
  - On Fridays
Closing Provocation

How should a 21st-century regulator move forward in small-dollar space?

• Set a high evidentiary bar
• Beta-test: soft vs. hard launches
• Try scalpels before sledgehammers
• Rely less on lawyers, examiners
• Rely more on marketers, researchers
Innovating in Small Dollar

- **Distribution channel**
  - Employer-intermediated lending
  - Online
- **Underwriting based on new data sources**
  - Employer data
  - Social media
  - Peer referrals
  - Spend and other transaction data
  - Recurring payment histories beyond prime credit
  - “Shockumentation” of emergencies
- **Contracting innovations**
  - Flexible repayment schedules
  - Maturity sweet spot
  - Dynamic pricing
- **Monitoring innovations**
  - Referral bounties
  - Peer support
- **Behavioral selection**
  - More-favorable terms for delayed disbursement
  - “Pay Yourself Back” post-loan